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NO PROFITS, NO CAPITAL

By George W. Eckelberry

Karl Marx managed to make "profits" the most horrible word in the English language. With nothing more than this connotation as the basis for their thinking, many who lay claim to the title of "economist" have built up a whole system of thought. What is taught in a number of our universities as economics is nothing but an elaboration of the bad repute into which an innocent word has fallen, and much of our legislation is similarly based.

Right now, labor union "economists" are taking advantage of the Marxist connotation to facilitate their demands for increased wages: If only the capitalists were satisfied with less profits (that is, with less loot), they could pay the workers more wages; the higher wages need not come out of the consumer's pocket by way of higher prices.

In view of this trend of thought, a recent report of the Securities and Exchange Commission is very illuminating. It tells in realistic fashion that profits have a very useful function in our economy and, far from being a form of robbery, they serve to keep the machinery of production from disintegrating.

In the second quarter of 1951, the report says, our corporations spent $6.8 billions on their productive capacity. Of this amount, $5.6 billions went into plant equipment, the balance into inventories. On the basis of this experience, the SEC predicted for the year a total expenditure of $24.8 billions for tools and raw materials.

Where will all this money come from? From that horrible thing called profits. Only $800 millions of the above $6.8 billions came from the sale of new shares. (If one could trace back to the source of this $800,000,000, one would come to profits again.) Long-term borrowing accounted for $1.6 billions (which came out of profits saved up for this very purpose). The other $4.4 billions that was put into the expansion program of the corporations came from their own profits. That is, the expansion was internally financed to the tune of 63 per cent.

These figures do not give an exact picture of what happened to the profits of the corporations. Our accountancy methods are not quite up to detailing economic phenomena. There is the matter of inflation which makes bookkeeping look foolish at times.

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The depreciation of plant and equipment is figured on the basis of original cost, and is usually quite inadequate when replacement becomes necessary. In addition to depreciation accruals, the corporations must dip into their current profits to help pay for new machinery. Rising prices of raw materials make inroads into profits necessary for replacement. That is to say, some of the $6.8 billions which the SEC tells us went into plant expansion really went into paying more for the new equipment than had been expected, and this increase had to come from profits.

All of this means that the improvement in the American productive machine is due entirely to plowing back into it those evil profits.

II

Currently under consideration in the Washington maelstrom is a proposal to put a "ceiling on profits". Labor leaders blame the inflationary trend to excessive corporate profits. Also, the late Labor Government of England consistently attacked profits. With profits the principal source of funds for the increased productive capacity which alone can combat inflation (barring a decrease in government spending), this attitude is downright wicked.

It should be clear that a tax on profits is a tax on capital. When funds ear-marked for expansion are confiscated, the expansion simply will not take place. Whatever the Welfare State may do with these funds, the net result must be a reduction of the productive capacity of the nation. Is the nation in better shape because it has less machinery?

In 1936 the Roosevelt Administration put through Congress a law that levied on profits not paid out in dividends. This was known as the tax on undistributed profits. It was a "pump-priming" measure, the idea being to get more money into circulation by consumer spending, following from the notion that a nation is enriched by spending rather than by production. A corporation could deduct from its income the amount paid out in dividends, but it was heavily taxed on the income it retained for expansion or contingency expenses. The tax was so high that it made retention of profits practically prohibitive.

At that time, it will be recalled, most corporations were in financial difficulties. Some were actually insolvent. New capital could not be attracted by stock issues, and the only source of capital funds for many companies was the earnings they could retain; yet this source the law practically closed up.

Some companies were so hard pressed that they induced stockholders to enter into a scheme to circumvent the dire consequences of the undis-

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tributed profits tax. The stockholders signed "consent dividends", certificates which committed them to report as income the dividends they had not received, so that the corporations could avoid the heavy penalty on undistributed profits.

At a time when the recovery of its industry was the country's greatest need, the undistributed profits tax actually worked toward its prevention. The law could well be described as an "enemy act". The disastrous effects of it were so obvious that it was repealed, after being in operation two years.

III

In 1946, corporation income tax blanks carried a request for a full explanation, in the event the corporation did not pay out to stockholders at least 70 per cent of its profits for the year. The Treasury Department announced that if less than 70 per cent were paid out, the presumption was that the corporation was accumulating profits so as to assist its stockholders in evading the tax on dividends. This 70 per cent rule was an administrative decree, not a provision of the law.

The policy of the Treasury Department in the administration of this rule is now easier than it was in earlier years. However, penalties are still imposed on corporations which cannot convince the income tax examiners that the profits being retained are reasonably necessary. Some corporations, to avoid difficulties with the Department, pay out 70 per cent of their net incomes even though prudent management is against it.

The purpose of Section 102 of the Income Tax Law, with the 70 per cent rule, is admittedly to increase the taxable income of the stockholders; the government is concerned with its "take", not with the productive capacity of the nation. It is always out to take "another whack at profits", regardless of the consequences to industry; and each "whack" is rationalized with some mumbo-jumbo about Wall Street.

This confiscatory attitude is perhaps best illustrated in the double taxation of profits, first on corporation income and again on dividends received by the stockholders; even the left-wing economist (unless he is an out-and-out Marxist) has difficulty in justifying this two-way absorption of capital.

Another fact reported by the SEC should be a matter of great concern; namely, less than 12 per cent of the funds needed for the expansion program of American corporations during the second quarter of 1951 was obtained by new issues of capital stock. In the year 1950, a supplemental report shows, total securities issued by all corporations amounted to $6.4

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billions, of which only 811 millions represented shares of common stock -- less than 13 per cent. Nearly 77 per cent represented borrowings in the form of long-term bonds and bank loans.

This trend has been noticeable for some years. More and more, corporations are resorting to borrowing funds that would normally be obtained from the sale of new stock. One reason for this is that interest paid on borrowed capital is deductible for income tax purposes; it is a cost of business and therefore evades application of the 70 per cent rule.

Thus, the opportunities for the common stockholder are definitely limited. In the final analysis, he is the real risk-taker. Any dividend paid to him must come out of profits remaining after the claims of the bondholder and preferred stockholder are satisfied. He shares in the excess profits, but he also ranks last in case of liquidation or bankruptcy. It might be properly said that the virility of our economy is in proportion to the opportunities offered to common stockholders. Today, thanks to our taxing policy, the opportunities are few. Business is being financed by profits and borrowing, not by taking in new partners.

IV

The facts brought out by the SEC indicate that the life of American industry is dependent on the earnings it can plow back into its plant equipment. It has practically no other source of needed capital. Any law placing a ceiling on profits will be fatal to our industry -- which is another way of saying that it will be fatal to our economy. The deterioration that must follow from such a law may not be immediately evident, but the eventual outcome is inevitable.

But, a ceiling law is not the only way to effect the same result. Corporation and excess profits taxes can eat into the heart of our business structure, even without any increase in the present rates. The erosion of capital through taxation, and the accompanying discouragement of private investment, cannot be denied; the consequence of this process must be the dependence of industry on government financing. There is already far too much evidence that the government is approaching the status of a national financial institution.

This is the type of creeping Socialism that has been fostered by the persistent attacks on business profits by the last two administrations. The disease can be stopped only by the abolition of the double tax on corporation profits; that would automatically kill section 102 and the vicious 70 per cent rule. Such a measure would restore to industry the freedom without which it cannot live -- the freedom to manage its funds. Without this freedom, how can the drift of Socialism be stopped?

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VOICE OF AMERICA: A number of members of Congress who have just returned from trips to Europe are loud in their criticism of the Voice of America. On their journeys, they have found few people in Western Europe who have either listened to the American broadcasts or been influenced favorably.

But the most indelible impression they have received is that, however small the effect in Western Europe, there is even less among the peoples of the Iron Curtain countries. This seems all the more striking to these members of Congress, because the Voice of America authorities have made quite a point of the influence they claim to wield on Russians and inhabitants of the Soviet satellite states.

How do they know this? Well, it seems that during the past year, the chiefs of the Voice have carried on an inquiry which has involved the questioning of literally thousands of refugees who have left Iron Curtain countries for the safety of Allied zones in the West. The State Department hired a corps of "public opinion" experts to interrogate these refugees and to study the replies. Among the nationalities interrogated were Germans (from the Eastern zone), Czechs, Poles, Hungarians, Roumanians and Bulgarians. There were also Russians from Soviet territory. Touring members of Congress and their staffs have learned on good authority that the replies are decidedly negative as to the effect of the work of the Voice of America on those behind the Iron Curtain.

These are the figures which have been given to the Congressional visitors: only about three-tenths of one per cent of the Iron Curtain refugees had ever heard of the Voice of America broadcasts before they left their homelands, or of the much publicized propaganda balloons set adrift eastward; and only about half of that percentage had ever listened to the broadcasts.

Army authorities in Germany were very interested in this interrogation and, as a collaborating agency in the process, had access to the findings. For a long time, the Army has been skeptical of the claims of the Voice of America that the broadcasts had been a major factor in inspiring a large number of Eastern Europeans to leave their homes and cross the Iron Curtain to the West. The questioning of refugees did not confirm this claim. It showed that almost all had fled for various personal reasons.

As for the handful who said they had heard the Voice broadcasts, the character of the American propaganda had a sharply negative effect. One refugee put their general reaction this way: "The Voice propaganda is for peace, peace, peace. But so is the propaganda from Moscow. Therefore, it looked to us as if there was no hope of liberation by the West, because that could only come through war. And we could look forward for the rest of our lives to oppression and poverty under Soviet yoke."

The visitors from Washington could only come to the following conclusion: since the Voice, as an official agency, is precluded from urging war and revolution among the slaves of the Soviet, and since its peace propaganda has the above effect, why vote large funds for its continuance?

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BEHIND THE HUNGARIAN INCIDENT: From responsible sources, we learn the unpublished version of how our diplomacy worked to obtain the release of the four American fliers

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imprisoned by the Red Hungarian Government. In Budapest, a diplomatic representative of the U.S. Government approached the Hungarian Foreign Office with conciliatory language. He sought to emphasize that actually the U.S. Government was not as indignant as it seemed. He pointed out that the State Department had to act energetically because of the state of American public opinion. In effect, he apologized for the apparent "impatience" shown by the diplomatic attitude of Washington. As we get the version, the colloquy was couched in somewhat the following words: Hungarian Foreign Office man -- "Have you no patience?"; American representative -- "I have, but the American people have not."

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REVOLT IN CALIFORNIA: The fight against "me-tooism" in the GOP has taken a rather conspicuous turn in California. The forces opposed to Republican leaders who ape the Fair Deal have turned their guns against Governor Warren as a symbol of "me-tooism" and are trying to prevent him from controlling the 70-man delegation which will go to the Convention next summer.

They are also seeking a figure around whom they can rally in their fight. It may be recalled that Senator Taft, when he announced his candidacy for the nomination, said he and his organization would stay out of California, thereby conceding the field in that state to Governor Earl Warren. As a result, the "anti-me-too" elements were left without a leader.

Indeed, so keen is the discontent -- among these elements -- with their Governor, whom they term a Republican Fair Dealer, that they have set out to find another figure under whose banner they can attempt to win a major portion of the California delegation. Many have turned to the name of General Douglas MacArthur, despite his insistence that he is not in politics. Others have raised a cry in favor of General A. C. Wedemeyer. General Wedemeyer was very popular when he served as the Commander of the Sixth Army, with headquarters in the Presidio, at San Francisco between 1949 and 1951. He won praise for his support of the loyalty oath at the University of California, a very controversial issue in that state. In this dispute, Wedemeyer opposed President Robert G. Sproul of the University, behind whom stood Governor Earl Warren.

In this movement against "me-tooism", many of the same people who waged so strong a campaign in behalf of Richard M. Nixon for Senator in his contest with left-wing Helen Gahagan Douglas in 1950 are now rallying behind MacArthur or Wedemeyer. This element, while also opposed to the Welfare State proclivities of Governor Warren, is especially marked by its opposition to Communists and fellow travellers. The Democratic Party, particularly in the southern part of the state, is shot through with persons of those categories. And Warren has seemed to court left-wing rather than right-wing electoral support.

The "anti-me-too" forces turned out to the number of 5,000 in a gathering in the Hollywood Legion Stadium on December 13; significantly, Senator Joseph McCarthy of Wisconsin was the principal speaker. The sponsor was the organization called "Americans for MacArthur". Besides assailing Communists in Government, McCarthy proposed General MacArthur as GOP candidate. He also mentioned a number of persons who might well fill the second place on such a ticket: Senator Knowland of California, Senator Dirksen of Illinois, former Governor Stassen and Sen. Styles Bridges of New Hampshire. He added that he would not support Governor Warren in the primaries because "Warren doesn't seem to have any remote grasp of the dangers of Communism in Government, colleges and elsewhere".

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McCARTHY: The Wisconsin crusader's stock rose again during the holidays. We described a fortnight ago how his cause was bolstered by the dismissal of State Department diplomat John S. Service, whom McCarthy had named when he first entered the controversy over eighteen months ago. But his big break took place on December 27,

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when a Senate committee investigator made public charges that sharpened the growing trend in favor of McCarthy.

Daniel C. Buckley, who had served as assistant counsel for the Senate Elections subcommittee investigation, claimed that the group's probe of the Senator from Wisconsin is part of a campaign to destroy anyone who fights Communism. Buckley said he was fired after reporting evidence which would clear McCarthy and scuttle accusations which Senator Benton had made against the Wisconsin Senator. Benton's avowed policy is to try to expel McCarthy from the Senate.

Buckley said that he had not been working for the Elections Committee long before he discovered that "I was expected to substantiate Sen. Benton's charges and to discredit Senator McCarthy at the expense of the truth". Buckley gave in detail various examples of the way the committee was being run. Evidence, which he gathered in Wheeling, W. Va., cleared McCarthy of charges of gross mis-statement, but the chief counsel -- not to mention Sen. Tydings who seemed to be in close connection with the committee -- sought to undermine this evidence.

Buckley summed up the two major aims of the committee investigation of McCarthy, as follows: "(1) To discredit and destroy any man who fights Communist subversion -- in this case, Senator McCarthy. (2) To instill fear in the minds of men -- a fear which our enemies hope will effectively scare loyal Americans, in private life and in Congress, into silence and prevent them from speaking out against the Communist threat in this country."

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WHAT PRICE GLORY? In the 1950-51 edition of Who's Who in America, there is a biographical sketch of the career of Alger Hiss, but none of Whittaker Chambers.

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IN DEFENSE OF WAGE BOOSTS: Out of Washington comes a volume of groans and growls about the latest round of wage demands and the consequent threat of higher prices. The caterwauling from the plush offices of the OPS, WSB and the White House, however, has a note of insincerity about it; the anguish seems make-believe. For, if the Administration has any fixed policy or any recognizable trend at all, it is the policy of "controlled" inflation. It wants wages to go up, it wants prices to rise -- within fixed limits, of course. The way to keep the country prosperous, contented -- and, therefore, voting for the right candidates -- is to keep depreciating the value of money ever so gently and imperceptibly. The economists of Harvard, Yale, Columbia and Siwash are all for it, and so are their students in said plush offices.

Now, inflation does not become apparent until the money shows up in the market place. And the money gets there by way of the pay envelope. That is, you can't have inflation unless the buying power of the consumer is increased and the amount of consumable goods remains fixed. With the government laying hands on so much of what is produced, there is no danger of more goods hitting the market. So, to bring about the desired inflation, it is only necessary to raise wages.

The sound of gnashing teeth now emanating from the conference rooms, where the union demands are being "considered", is all part of the act. Of course, the steel workers will get a raise, and the steel companies will be allowed to increase their prices. And the other industries will follow suit.

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COMPOSITE LETTER: The following from one of our readers expresses a problem that has been put to us by several others. "Can you send me the names of textbooks for use at the junior high school level which emphasize the values of limited Constitutional government, the Bill of Rights, and our traditional anti-collectivism? Can you refer to me a college where these values still obtain?" There may be such textbooks and colleges, but we do not know of them.

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Book Events

Flight In The Winter, by Juergen Thorwald. New York: Pantheon Books. $3.75. Reviewed by William Henry Chamberlin.

This book is to be welcomed because it rips to shreds one of the velvet curtains of the late war. It pieces together more completely than anything available in the English language one of the great horror stories of the war, a story that was ignored for years after it had occurred. This is the orgy of murder and torture, rape and pillage that marked the irruption of the Soviet armies into Germany in the first months of 1945.

If one can imagine a combination of the sack of Rome by Alaric's Goths, and later by the army of Charles V, the raids of Genghis Khan's hordes, the Apache Indians on the loose and some peculiarly horrible lynchings thrown in, one gets a fair idea of what this Soviet invasion meant to the men, women and children who experienced it. The present book is an abridgment of a two volume work in German by the same author, published under the title: "It began on the Vistula; it ended on the Elbe".

It is a painstaking reconstruction, on the basis of available official reports and much interrogation of eyewitnesses, of what happened between the beginning of the Soviet offensive on the Vistula in mid-January and the capture of Berlin in May. Militarily the struggle was hopeless from the beginning. The Soviet preponderance in manpower and, still more, in tanks and artillery, was overwhelming. The defeat was even swifter and more catastrophic than it might otherwise have been because of Hitler's insistence on directing operations personally.

He refused any maneuvering discretion to his generals, opposed the transference of an army which was useless in Courland, locked up considerable numbers of troops in indefensible "fortresses" and committed about every imaginable military blunder. There is a vivid account of the last days of Berlin, with Hitler finally committing suicide, along with his new bride, Eva Braun, rather than fall alive into the hands of his foes.

The grim quality of this tragic epic is best conveyed, perhaps, by a few brief quotations:

"Not one German in his village escaped. Not one woman escaped and not one girl -- the seventy-year-old ones no more than those of twelve. If they had hidden in the barn, flames drove them out. The local farm leader's wife died under the rapings. But other women died too, after they had been taken by twenty men or more. The men died -- all but four who escaped by mere chance. . . . In Schiedlow, southwest of Oppeln, I once saw some twenty Red Army men standing in line before the corpse of a woman certainly beyond sixty years of age who had been raped to death. They were shouting and laughing and waiting for their satisfaction over her dead body. It was the most terrible thing I have ever seen. . . ."

When one makes every allowance for the fact that every army has its share of hoodlums and criminals, that every invasion is marked by some outrages and excesses, the wholesale bestiality recorded here exceeds anything known in the annals of European warfare. Russian troops were in Western Europe during the Napoleonic wars; but there is nothing in Count Tolstoy's classic War and Peace (which was distinctly not a government propaganda work) to suggest that they were any worse in their behavior than the Austrians, Prussians and French soldiers with whom they were allied or whom they were fighting.

The facts recorded in this book have been hidden from Americans by a velvet curtain, but are well known to Germans and citizens of other countries "liberated" by the Red Army.

There is little cause for surprise if Germans are skeptical and cynical about the Nuremberg "war crimes" trials which did not touch one of the barbarians who rampaged through East Germany.

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